

**PAPER – 19: COST AND MANAGEMENT AUDIT**

**SUGGESTED ANSWERS**

**SECTION – A**

**1.**

- (i) (C)
- (ii) (C)
- (iii) (C)
- (iv) (C)
- (v) (A)
- (vi) (C)
- (vii) (B)
- (viii) (A)
- (ix) (B)
- (x) (A)

**SECTION – B**

**2. (a)**

- (i) In the present case, the Auditor has deemed to have vacated his office. For any casual vacancy of Cost Auditor shall be filled by the Board of Directors within 30 days of occurrence of such vacancy.
- (ii)
- (a) The fresh appointment has to follow the same procedure as for appointment of original Auditor, viz. (a) in the case of companies which are required to constitute an audit committee- (i) the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;(ii) the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;
- (b) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint cost auditor fixing the remuneration and the remuneration so fixed shall be ratified by shareholders.
- (iii) The new Cost Auditor shall submit acceptance letter along with eligibility certificate after receiving the offer of appointment.
- (iv) Within 30 days of Board meeting in which appointment is made, the Company shall file a Revised Notice to Central Government through electronic mode, in Form CRA -2 along with fees as per Rules.

**2. (b)**

The Part I of the Second Schedule to the Cost and Works Accountants Act, 1959 stipulates that a cost accountant in practice shall be deemed to be guilty of professional misconduct, if he:

- (i) Fails to disclose a material fact known to him in a cost or pricing statement, which is not disclosed in a cost or pricing statement, but disclosure of which is necessary in making such statement, where he is concerned with such statement in a professional capacity;
- (ii) Does not exercise due diligence, or is grossly negligent in the conduct of his professional duties;

- (iii) Fails to invite attention to any material departure from the generally accepted procedure of costing and pricing applicable to the circumstances;

In the given case, the Cost Auditor has not disclosed the fact of changing the accounting policy in the valuation of inventory and the resultant loss in the books of account for the year 2022-23. Hence, the Cost Auditor is deemed to be guilty of Professional Misconduct.

### 3. (a)

- (i) The items to be included in computing Transportation Cost as per CAS 5 are:

- Variable Costs
  - Salaries, Wages of Drivers, Cleaners, Others
  - Fuels & Lubricants
  - Consumables
  - Amortized cost of Tyre, Tube, Battery, Spares
  - Repairs and Maintenance
  - Other Variable Costs
- Fixed Cost
  - Insurance
  - License, Permit Fee
  - Depreciation
  - Other Fixed Cost to be specified.
- Items not included in Transportation Costs
  - Penalty
  - Detention charges
  - Demurrage
  - Break-down costs
  - Abnormal and non-recurring expenses

- (ii) The following basis may be used, in order of priority, for apportionment of outward transportation cost depending upon the nature of products, unit of measurement followed and type of transport used :

- Weight
- Volume of goods
- Ton - Km
- Unit / Equivalent unit
- Value of goods
- Percentage of usage of space

Once a basis of apportionment is adopted, the same should be followed consistently.

### 3. (b)

Particulars	Current Year (₹)
Profit as per Financial Accounts	1,34,27,516
Interest Income from inter-corporate Deposits	(-)6,14,250
Loss on Sale of Fixed Asset	(+)1,04,148
Donations not considered in Cost Accounts	(+)4,75,250
Difference in value of cement taken for own consumption	(-)30,720
Difference in Stock Valuation	(+)24,62,523
Cost of Power Drawn from Windmill	
(Additional cost in Cost Accounts)	(-)14,47,995
Profit as per Cost Accounting Records:	1,43,76,472

#### **4. (a)**

##### **Benefits of Management Audit:**

- (i) It helps management in framing basic policies for the organisation and to define objectives.
- (ii) In pursuance of the objectives of the organizations, management audit helps in preparing a viable and achievable plan for the organization.
- (iii) It helps in setting up an organizational framework to implement the plans.
- (iv) It assists in designing systems and procedures for smooth operation of the organisation.
- (v) It helps in designing systems and reviewing management information system (MIS) for decision making to help in coordination, motivation and control of the operations.
- (vi) It assists in analysing SWOT (Strengths, Weaknesses, opportunities and threats) of the organisation and assists in marketing the organisation stronger.
- (vii) In a developing country like India, management audit through CAG, public accounts committee and parliamentary committee on public undertakings, has helped the Government in identifying improper or wasteful use of funds, checking extravagant organization practices and curbing ineffective use of physical resources.
- (viii) Indian financial institutions, banks and Board for Industrial Finance and Reconstruction (BIFR) have found management audit useful in monitoring sick industrial units and to help the units in their rehabilitation.
- (ix) The Railways of India have subjected their finances to open discussion by public to improve resource mobilization, reduce cost of operations and conserve their scarce resources which are main objectives of management audit.
- (x) It can help in analysing social-cost benefit analyses for public projects like dams, power houses, national highways etc.
- (xi) It is essential whenever a unit is planned to be taken-over or an amalgamation or merger with other unit is proposed.
- (xii) Growing number of professional managers, the continuing separation of ownership from management, the wider distribution of stockholders, increasing competition and sickness in industry will sooner or later make certified management audit compulsory just as financial audit has become statutory.

#### **4. (b)**

Certain industries focus on segmentation of its products in limited markets and customer types, depending on its production capability and market behavior of the products. The management may choose to understand its position in the different markets and different customers it serves. The auditor should observe the segmentation method adopted by the company for analyzing its profitability.

##### **The objective is to**

- (i) take suitable action for the segments that are not performing as per desired targets by introducing campaigns or pull out of those segments that are no longer attractive.
- (ii) analyze the demand pattern based on geographical areas or customer profiles or other channels of distribution and to see, if there is any shift of preference.
- (iii) Variation of turnover vis a vis that of profitability be measured to locate the exact area of operation which is lagging.
- (iv) A study of concentration risk viz. overdependence on a few customer or area may locate possible weaknesses.
- (v) The checklist will consist a) study of Market and customer-wise sales and cost reports b) The marketing campaigns undertaken by the company c) Date on new markets or new customers added during the year and d) market study to see if any variation has taken place in customer preference and product usage.

### **5. (a)**

Internal Accounting control comprises of the plan of an organization and the procedures and records that are concerned with the safeguarding of assets and the reliability of financial controls. Internal control, so far as financial and accounting aspects are concerned, aims at the following:

- (i) Providing the flow of work through various stages.
- (ii) There should be proper segregation of personnel duties so that no single person can be in a position to handle whole of the work from its beginning to its end.
- (iii) Adequate documentation should be made at each stage of work.
- (iv) The transactions are recorded with appropriate amounts and in timely manner and that too as per the applicable accounting policies and practices.
- (v) The assets should be properly safeguarded. The access to the assets should be restricted to only authorized persons.
- (vi) Existence of organizational chart would help in fixing responsibilities.
- (vii) Building up of a system to locate the deviations and departures from the prescribed procedures and to detect the frauds and errors automatically without much loss of time.
- (viii) Standardized records and formats should be evolved. It would ensure availability of right information at right time.
- (ix) There should be an efficient Management Information System.
- (x) Minimization of loss and wastages.
- (xi) Employees should be encouraged to do good work and comply with the procedures. Special attention should be given to the disgruntled employees.
- (xii) Adequate cut off procedures should be formulated so that the transactions of one period can be separated from the transactions of other period. The Auditor should obtain an understanding of the accounting system sufficient to identify and understand major classes of transactions, manner of initiation of transactions, significant accounting records, supporting documents and specific accounts in the financial statements and the accounting and financial reporting process.

### **5. (b)**

While planning the audit of a Non-Governmental Organization (NGO), the auditor may concentrate on the following;

- i. Knowledge of the NGO's objective, mission, and vision, areas of operations, and environment in which it operates.
- ii. Reviewing the legal form of the organization and its Memorandum and Articles of Association, rules, and Regulations.
- iii. Reviewing the NGO's Organization chart, Financial and Administrative Manuals, Project and Program Guidelines, and Funding Agencies Requirements and Formats.
- iv. Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
- v. Study the accounting system, procedures, and internal controls and verify their applicability.

The audit program should include in sequential order all assets, liabilities, income, and expenditures ensuring that no material is omitted, and details vouched and/ or checked particularly in the following heads:

- a) Corpus fund.
- b) Reserves.
- c) Ear-marked Funds.
- d) Project/Agency Balances.
- e) Loans.

- f) Investments.
- g) Cash in Hand.
- h) Bank Balance.

**6. (a)**

- (i) Average Capital Employed = ₹ 1,414.50 (₹ in Lakh)
- (ii) Net Worth = ₹ 963 (₹ in Lakh)
- (iii) Profit Before Tax to Capital Employed = 12.02%
- (iv) Profit Before Tax to Net Worth = 17.65%

**6. (b)**

Process	Waste Multiplier
Total Consumption	1.3161
Blow Room	1.1994
Carding	1.1158
Draw Frames	1.1027
Roving(Simplex)	1.0906
Ring Frames	1.0153
Reeling and Winding	1.0000

**7. (a)**

**Estimated Cost and Price Quotation**

Carbon Fibre Drone Frame – Lot of 100 units	₹
Total cost	71,925
Sales price (profit 15% of sales)	84,618
(Estimated Profit- Balancing fig)	12,693

**7. (b)**

**Abnormal fixed cost**

Stoppage	Abnormal Fixed Cost ₹ lakh
Full stoppage 60 days	755
Partial stoppage 22 days	174
Exclude Fixed cost for total stop of 82 days	929

**8. (a)**

The objective of Cost Auditing Standard 102 is to provide guidance to prepare documentation that provides

- (i) Sufficient and appropriate record of the basis of Cost Auditor's Report
- (ii) Evidence that the audit was planned and performed in accordance with Cost auditing Standards and applicable legal & regulatory requirements

The Standard deals with the Cost Auditor's responsibility to prepare audit documentation for audit of cost statements, records and other related documents. The specific documentation requirements of other Cost auditing standards do not limit the application of this auditing standard. Laws and regulations may establish requirements of additional documents.

**8. (b)**

An audit program, also called an audit plan, is an action plan that documents what procedures an auditor will follow to validate that an organization is in conformance with compliance regulations. It is a written plan containing exact details with regard to the conduct of Internal Audit like others. It is a description of the work to be done during an audit. A specimen of an audit program is given below:

**ABC Ltd Audit program of Internal Audit Wing**

Internal Audit Staff Involved:	Mr. A- Internal Auditor, H.O.D Mr. B, / Mr. C, / Mr. D, etc.		
Particulars	Remarks	Time Taken	Signature
Management Confirmation			
Cash Book			
Bank statements			
Bank Reconciliation			
Purchase Book			
Various other Ledgers ...			
Compliance of various laws on Return submission etc.			
Safeguarding assets			
Defaults leading to loss			
Any other as deemed fit.			

**8. (c)****Functions of Management Audit**

The functions of management audit extend to audit of the effective functioning of every area of operations coming under the management purview from the stage of its planning to proper implementation and execution. Every manufacturing or service organisation could broadly be identified into the following functional areas –

- (i) Marketing, including selling and distribution.
- (ii) Manufacturing/servicing, including maintenance of supply chain, machinery and equipment, etc.
- (iii) Human resource management from selection to recruitment, training, motivating, retaining, advancement, etc.
- (iv) Personnel policies and industrial relations.
- (v) Finance including maintenance of accounts and providing accounting information to guide the management of its performance and position.
- (vi) Research & development including application research and basic research, if any.

An understanding of the objectives of each functional area at every level of the organisation and effectively achieving such objectives shall be the prime responsibility of management. Checking of such effective achievement is the function of management audit.

**8. (d)**

The cost of idle time = ₹ 1,071

**8. (e)**

**Cost Auditor's Observations and Conclusions:**

The profit of the company has declined by ₹ 90 lakhs during the year 2023, as compared to the year 2022.

**This may be due to the following reasons:**

- i.** Production during the year 2023 has decreased by 10,000 MT. This is perhaps due to the underutilization of capacity from 95% to 90%. It may also be due to a scarce power supply.
- ii.** Based on further analysis and scrutiny, it is noted that the cost of production/ Tone has increased (Assumption).
- iii.** It has also come to light that the price of the product in the market has declined. This may be due to stiff competition. (Assumption).
- iv.** Profit as a % of Capital Employed has declined from the figure of 30.9% in 2022 to 20.8% in year 2023. This is partly due to a decline in the amount of profit and partly due to an increase in capital employed.
- v.** The consumption of electricity in terms of kwh/ Tone of output has increased from 3.98 in 2022 to 4.07 in 2023. This is a serious matter which needs investigation and necessary action is to be initiated.
- vi.** There is an increase in Salaries and Wages by ₹ 19 lakhs. This is due to the following reasons:
  - a)** Increase in ₹ 7 lakhs due to increments and promotions (Assumptions).
  - b)** Increase in ₹ 3 lakhs due to additional DA paid to the workers (Assumptions).
  - c)** Remaining ₹ 9 lakhs is due to the employment of new workers (Assumptions).

Engagement of these new workers is not justified on economic considerations and this has resulted in excessive idle time. Additional work needs to be created for these workers.